

IN THE HIGH COURT OF GUJARAT AT AHMEDABAD

INCOME TAX REFERENCE No 216 of 1977
with
INCOME TAX REFERENCE No 268 of 1977

For Approval and Signature:

Hon'ble MR.JUSTICE R.K.ABICHANDANI and
MR.JUSTICE R.BALIA.

- =====
1. Whether Reporters of Local Papers may be allowed to see the judgements?
 2. To be referred to the Reporter or not?
 3. Whether Their Lordships wish to see the fair copy of the judgement?
 4. Whether this case involves a substantial question of law as to the interpretation of the Constitution of India, 1950 of any Order made thereunder?
 5. Whether it is to be circulated to the Civil Judge?

ITA 216/77
COMMISSIONER OF INCOME-TAX

Versus

DR.ANAND SARABHAI

ITA 268/77
COMMISSIONER OF INCOME TAX
Versus
EXECUTORS & TRUSTEES OF DR. VIKRAM SARABHAI

Appearance:

MR MH JOSHI FOR MR MANISH R BHATT for Petitioner
M/S DA MEHTA, RK PATEL, AND BD KARIA FOR MR KC PATEL for
Respondent No. 1

CORAM : MR.JUSTICE R.K.ABICHANDANI and
MR.JUSTICE R.BALIA.

Date of decision: 26/02/97

ORAL JUDGEMENT

(Per R.K.Abichandani, J)

1. The following questions had been referred to this Court for its opinion under Section 256(1) of the Income Tax Act, 1961, in the above two references:

Income Tax Reference No. 216 of 1977:

1. "Whether, on the facts and in the circumstances of the case, the Income-tax Appellate Tribunal was right in law in holding that the distributions received by the assessee from various discretionary trusts were assessable only in the hands of the trustees of the respective trusts under Section 164 of the Income-tax Act, 1961, and not in the hands of the assessee?"
2. "Whether, on the facts and in the circumstances of the case, the Income-tax Appellate Tribunal, was right in law in holding that the sum of Rs.11,990/received by the assessee from various discretionary trusts is exempt from tax inasmuch as the said sum was paid out of dividends received by the trusts which were exempt under Section 80-K of the Income-tax Act, 1961?"

Income Tax Reference No. 268 of 1977:

1. "Whether, on the facts and in the circumstances of the case, the Income-tax Appellate Tribunal was right in law in holding that the distributions received by the assessee from various discretionary trusts were assessable only in the hands of the trustees of the respective trusts under Section 164 of the Income Tax Act, 1961 and not in the hands of the assessee.
2. Whether, on the facts and in the circumstances of the case, the Income Tax Appellate Tribunal was right in law in holding that the amount received by the assessee from various discretionary trusts is exempt from tax inasmuch as the amount was paid out of dividends, received by the trusts which were exempt

under section 80-K of the Income-tax Act,
1961?"

2. These references were earlier heard and decided on 1.3.1978 and on Question No.1 of these two references, the Court opined that the Tribunal was right in law in holding that the distributions received by the assessee from various discretionary trusts were assessable only in the hands of the trustees of the respective trusts under section 164 of the Act and not in the hands of the assessee. The Question No.1 in both these references was therefore answered in the affirmative in favour of the assessee and against the revenue. As regards Question No.2 of these two references, it was held that in view of the answer on the Question No.1 as above, it was not necessary to answer the Question No.2. The matter was carried to Supreme Court in Civil Appeals No. 2154 of 1978 and Civil Appeal No.2157 of 1978, and the Supreme Court by its order dated 7th February 1996 reversed the judgement of the High Court following the decisions of the Supreme Court in C.I.T. v. Kamalini Khatau reported in 209 ITR 101 in which it was held that the Revenue has the option to assess and recover tax from either the trustees or the beneficiaries of a discretionary trust in respect of such income thereafter as has been distributed to and received by the beneficiaries in the course of accounting year, and answered the Question No.1 in negative in favour of the Revenue and against the assessee. As a consequence of this, the Supreme Court directed that the Question No.2 in these two references was now required to be gone into and answered. The matters have therefore been remitted to this court to consider and answer the Question No.2 alone in accordance with law.

3. Income Tax Reference No. 216 of 1977 relates to the assessment year 1969-70 where the assessee is an individual. Assessment was completed by the Income Tax Officer on 31.12.1971 at a total income of Rs.1,04,086/-. The assessee had received an amount of Rs.11,990/- from as many as ten trusts, as detailed in the assessment order. The Income Tax Officer had assessed the said receipts in the hands of the assessee and following his earlier order in Kamalini Khatau case allowed to the assessee a deduction under Section 80K of the Act on a proportionate basis in respect of the said receipts, and rejected the assessee's claim that its receipts came out of exempt portions of the trust income, bringing an amount of Rs.3510/- to tax out of the said receipts. In an appeal, the Appellate Assistant Commissioner, following the decision of the Tribunal dated 26.11.1975

in Kamalini Khatau vs. I.T.O. held that the receipts could be taxed only in the hands of the trustees and accepted the assessee's contention that the deductions under Section 80K would be allowable in the assessee's hands completely and not merely on a proportionate basis. In appeal before the Tribunal preferred by the Revenue, the Tribunal found that the decision of the Tribunal in the case of Smt. Kamalini Khatau rendered on 26.11.1975 had continued to hold good and since there was no distinguishing feature, there was no reason to depart from that earlier decision. It was, therefore, held that the income in question was assessable only in the trustees hands. The decision on this Question, as we have noted above, no longer stands in view of the decision of the Supreme Court on Question No.1.

4. The Tribunal, as regards Question No.2, while observing that it did not survive gave a finding on an assumption that if it were to survive then it was a question of fact to be decided in each case separately on the basis of the material on record as to whether the amount received by the assessee was disbursed by the trustees out of the dividend income eligible for deduction under Section 80K of the Act. It was noted that the Department's argument was not that the amount received by the assessee did not come from the separate account maintained by the trustees of the respective trusts in respect of the amount of division which was eligible to deduction. The Tribunal negatived the department's contention that even when the entire receipt in the beneficiaries hands was shown to have come out of the separate account of the trust regarding exempt income, the beneficiary was to be taxed in the terms of Section 165. It was thus held that the sum of Rs.11,990 received by the assessee was eligible for deduction since it was paid out of the dividends received by the trusts which were so eligible under Section 80K of the Act.

5. In Income Tax Reference No. 268 of 1977 the relevant assessment year was 1969-70 and on similar facts as in the other case, the Tribunal following its decision in the case of Kamalini Khatau held that the income could be taxed only in the hands of the trustees of the respective trusts, under Section 164 of the Act. In that case, direct assessment was made in the hands of the beneficiary - assessee in respect of Rs.39,230/- received by the assessee from 18 trusts. According to the assessee even if the amount was computed in the hands of the assessee it would be deductible under Section 80K of the Act in the hands of the trustees. The Income Tax Officer assessed the distributions in the hands of the

beneficiaries and held that only a portion of the 80K dividend was exempt. The Appellate Asst. Commissioner however held that the income could be taxed only in the hands of the trustees. The Tribunal upheld the decision of the Appellate Assistant Commissioner. As noted above, the second Question that had arisen in that case calls for our consideration in view of the direction of the Supreme Court.

6. It was contended on behalf of the revenue that the benefit of deduction under Section 80K in respect of dividends attributable to profits and gains from new industrial undertakings, would be permissible only on proportionate basis. It was further contended that under Section 165 of the Act, it is the proportionate chargeable receipt that could be brought to tax. On the other hand, it was contended on behalf of the assessee that only the provisions of Section 80K were applicable to the instant case under which deduction was allowable in the assessee's hands completely and not on the basis of proportion it bears to the total income of the trust, as contended by the revenue.

7. The relevant provisions of Section 80K which prevailed at that time read as under:

"80K. Deduction in respect of dividends attributable to profits and gains from new industrial undertakings or ships or hotel business. - Where the gross total income of an assessee, being the owner of any share or shares in a company, includes any income by way of dividends paid or deemed to have been paid by the company in respect of such share or shares, there shall, subject to any rules that may be made by the Board in this behalf, be allowed, in computing his total income, a deduction from such income by way of dividends of an amount equal to such part thereof as is attributable to the profits and gains derived by the company from an industrial undertaking or ship or the business of a hotel, on which no tax is payable by the company under this Act for any assessment year commencing prior to the 1st day of April, 1968, or in respect of which the company is entitled to a deduction under Section 80J."

8. The provisions of Section 165 of the Act which relate to cases where part of trust income is chargeable are as follows:

"165. Where part only of the income of a trust is chargeable under this Act, that proportion only of the income receivable by a beneficiary from the trust which the part so chargeable bears to the whole income of the trust shall be deemed to have been derived from that part."

9. The assessee had received distribution from ten discretionary trusts in which he was the beneficiary. The Income Tax Officer admittedly assessed the receipts from the discretionary trusts as the assessee's income of the year. That could have been done in view of the ratio of the decision of the Supreme Court in C.I.T. vs. Kamalini Khatau reported in 209 ITR 101 and on the basis of which Question No.1 has been answered by the Supreme Court in the present two references. We are however, concerned with the question as to whether distribution of the dividends which are eligible for deduction under Section 80K when passed on to the assessee's would also be eligible for such deduction. According to the learned counsel for the assessee whatever dividends that were eligible for deductions were passed on to the assessee's who were the beneficiaries would automatically become eligible for deductions even in the hands of such assessee. It therefore falls for our consideration as to whether such amounts received by the beneficiaries will be eligible for deductions under Section 80K or whether they should be treated under Section 165 as exempt in proportion which the amount bears to the total income of the trust.

10. The provisions of Sections 160 to 167 would indicate that the person charged with tax is neither the trustee nor the beneficiary, as such, but the person in actual receipt and control of the income which it is sought to reach. If the beneficiary receives the profits he is liable to be assessed on them and if the trustee receives and controls them, then he is primarily liable. These are the principles underlying the provisions of Sections 160 to 167. Section 166 of the Act makes it clear that Sections 160 and 161 are enabling provisions giving option to the department to assess the representative assessee or directly the beneficiary entitled to the income. The combined effect of Section 166 and 167 of the Act is that the Department can assess the representative assessee or the beneficiary entitled to the income, and, having assessed either of the two, recover the tax from the property held by him or by the other.

11. Section 165 indicates that when part only of the

trust income was chargeable under the Act, the beneficiaries' share of the income should be taken to be derived proportionately from the chargeable and non chargeable portions of the trust income, and should be assessed accordingly. Thus if the income of the trust is Rs.10,000/-, of which Rs.5,000/- is chargeable under the Act and Rs.2500 is receivable therefrom by beneficiary, the proportion of part chargeable, i.e., Rs.5000/- to the whole income of Rs.10,000 being 2:1, the same proportion will apply to the income receivable by the beneficiary, for the purpose of working out the chargeable and non chargeable portions. Tax is required to be collected in respect of income chargeable under sub section (1) of Section 4. Therefore, the proportion of income chargeable to tax is to be worked out in respect of the income receivable by the beneficiary in that context, and that is quite different from the specific question of dealing with the dividends attributable to profits from new industrial undertakings or shops or hotel business which was dealt with by the provisions of Section 80K of the Act. Income by way of dividends is income chargeable under the Act and if it is chargeable in the hands of the trustees, it will in respect of the amount that goes to the beneficiary remain chargeable in the hands of the beneficiary in the aforesaid proportion. However, that is distinct from the question of deductions allowable under Section 80K which can be invoked in respect of chargeable income received by way of dividends from the company by the assessee owner of the shares to the extent of the benefit indicated thereunder. Accordingly, in computing the total income of such assessee a deduction to the extent indicated in Section 80K is to be made from 'such income' i.e., income paid by the company by way of dividends to him. The working out of the amount of deduction is linked with profits and gains derived by that company from the industrial undertaking etc., in respect of which the company is entitled to a deduction under Section 80J of the Act. The breakup is reflected in the dividend certificate issued by the company which indicates the amounts that would become deductible under Section 80K in the hands of the assessee receiving the dividend. The portion of the dividend which is not attributable to the profits and gains of the company in respect of which that company was not entitled to a deduction under Section 80J would not qualify for deduction under Section 80K in the hands of the assessee. The provisions of Section 80K operate in context of the dividend income received from a particular company and therefore the deductible amount is to be worked out in respect of the dividend warrants received from that company. Thus if the entire income of the dividend

received by the assessee is referable to profit and gains of the company which in their entirety are deductible under Section 80J of the Act, then the entire amount of income by way of dividends will be allowable for deduction under Section 80K even in the hands of the assessee receiving it. The underlying idea is to ensure that the benefit under Section 80J proves to be real and that it should enure even in the hands of the shareholders who would thereby be encouraged to make investments in such company. The deductibility under Section 80K, of the amount of the dividend, or its part which is attributable to the profits and gains for which the company is entitled to a deduction under Section 80J, would remain the same when computed either in the hands of the trustee as representative assessee or in the hands of the beneficiary. Such dividend income passed on by the trustee to the beneficiary will still remain a dividend income in the hands of the beneficiary if the department opts to directly assess the beneficiary and it cannot be said that such dividend income will change its colour and become income received from the trustees by the beneficiary and seized to be dividend income. Such contention canvassed for the Revenue ignores the fact that the same income could be assessed either in the hands of the trustee as a representative assessee (who is deemed to be an assessee for the purpose of the Act under Section 160(2), or, in the hands of the beneficiary, in view of Section 166 which enables the Department to directly assess the person on whose behalf or for whose benefit income is receivable. Thus in our view the amount of the dividend income received by the trustee which was allowable for deduction under Section 80K when passed on to the beneficiary would nonetheless be eligible to the same deduction. In the present cases, the amounts disbursed by the trustees out of such deductible dividend income would therefore be eligible for deductions under Section 80K in the hands of the assessees. Therefore, while directly assessing the beneficiaries in respect of the dividend income received by them, the amounts of dividends eligible for deduction under Section 80K are required to be deducted in the same manner as would have been done had the trustees been assessed in respect of such amounts. Thus, when admittedly the amounts were paid by the trusts out of the dividend income which was in the hands of the trusts eligible to deduction under Section 80K as has been found on facts, the Tribunal was right in holding that such deductible amount received by the assessees from these discretionary trusts were eligible for deduction under Section 80K. The Question No.2 referred to us is therefore answered in the affirmative against the revenue

and in favour of the assessee in both these references.
Both the references stand disposed of accordingly with no
order as to costs.
